CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

October 6, 1998

H.R. 10
Financial Services Competition Act of 1998

As reported by the Senate Committee on Banking, Housing, and Urban Affairs on September 18, 1998

SUMMARY

H.R. 10 would eliminate certain barriers to ties between insured depository institutions and other financial services companies, including insurance and securities firms. While these changes could affect the government's spending for deposit insurance, CBO has no basis for predicting whether the long-run costs of deposit insurance would be higher or lower than under current law. Because insured depository institutions pay premiums to cover these costs, any such changes would have little or no impact on the budget over time. CBO estimates that implementing this act would decrease other direct spending by $88 million in 1999 and $345 million over the 1999-2003 period, and would decrease revenues by $1 million in 1999 and $17 million over the 1999-2003 period. Assuming appropriation of the necessary amounts, CBO estimates that federal agencies would spend between $3 million and $4 million annually to carry out the provisions of the act, once fully implemented. Because H.R. 10 would affect direct spending and receipts, pay-as-you-go procedures would apply.

H.R. 10 contains several intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA), but CBO estimates that the costs of complying with these mandates would total less than $10 million annually and thus would not exceed the threshold established under that act ($50 million in 1996, adjusted annually for inflation). H.R. 10 also contains several private-sector mandates as defined in UMRA. CBO's estimate of the cost of those private-sector mandates is detailed in a separate statement.

DESCRIPTION OF THE ACT'S MAJOR PROVISIONS

H.R. 10 would:

- permit affiliations of banking, securities, and insurance companies;

- generally prohibit the mixing of commerce and banking and, after September 3, 1998, prohibit any company engaged in commercial activities from acquiring control of a savings and loan association;

- amend the Federal Deposit Insurance Act to prevent the use of deposit insurance funds to assist affiliates or subsidiaries of insured financial institutions;

- provide for a new type of wholesale financial institution (WFI) that does not accept retail insured deposits; WFIs affiliated with insured banks would be subject to the Community Reinvestment Act;

- amend the Investment Company Act of 1940 to clarify the role of banks as custodians of investment assets; define which products banks may sell without registering with the Securities and Exchange Commission (SEC);

- require the Federal Reserve Board to coordinate with the Treasury when determining which products qualify as financial in nature, and provide expedited judicial review when federal and state regulators disagree about whether a product qualifies as insurance;

- create a system of functional regulation, whereby institutions that conduct banking, securities, or insurance activities would be regulated by the agency responsible for each such activity;

- prohibit obtaining personal financial information under false pretenses;

- reform the Federal Home Loan Bank (FHLB) System, making membership voluntary and replacing the $300 million annual payment make by the FHLBs for interest on bonds issued by the Resolution Funding Corporation (REFCORP) with an assessment set at 20.75 percent of the FHLBs' net income;

- permit an affiliation between a depository institution and the Student Loan Marketing Association, a government-sponsored enterprise;

- require the General Accounting Office (GAO) to prepare five reports, including an annual study on market concentration in the financial services industry; and

- create a National Association of Registered Agents and Brokers, a nonprofit corporation responsible for developing and enforcing uniform licensing standards for insurance-related products.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

H.R. 10 would make a number of changes affecting direct spending and revenues, which would result in increased spending by the banking regulatory agencies, decreased spending by the Treasury (equal to the increase in spending by the FHLBs), and a decrease in the annual payment—recorded as revenues—that the Federal Reserve remits to the Treasury. CBO estimates that direct spending would decrease by about $345 million over the 1999-2003 period. We estimate that enacting H.R. 10 would decrease revenues by $17 million over the same period. The act also would lead to an increase in discretionary spending of an estimated $13 million over the 1999-2003 period, assuming appropriation of the necessary amounts. The estimated budgetary impact of H.R. 10 is shown in the following table. The budgetary effects of this legislation on outlays fall within budget functions 370 (commerce and housing credit) and 900 (interest).

	By Fiscal Year, in Millions of Dollars					
	1998	1999	2000	2001	2002	2003
DIRECT SPENDING						
Spending Under Current Law [a]						
Estimated Budget Authority	2,328	2,328	2,328	2,328	2,328	2,328
Estimated Outlays	-2,485	-1,720	-486	180	758	1,143
Proposed Changes						
Estimated Budget Authority	0	-89	-95	-67	-53	-50
Estimated Outlays	0	-88	-93	-65	-51	-48
Spending Under H.R. 10 [a]						
Estimated Budget Authority	2,328	2,239	2,233	2,261	2,275	2,278
Estimated Outlays	-2,485	-1,808	-579	115	707	1095
CHANGES IN REVENUES						
Estimated Revenues [b]	0	-1	-4	-4	-4	-4
CHANGES IN SPENDING SUBJECT TO APPROPRIATION						
Estimated Authorization Level	0	1	4	3	3	3
Estimated Outlays	0	1	4	3	3	3

a. Includes spending for deposit insurance activities (subfunction 373) and Treasury payments for interest on REFCORP bonds.

b. Includes changes in the Federal Reserve surplus. A negative sign indicates a decrease in revenues.

BASIS OF ESTIMATE

Direct Spending and Revenues

H.R. 10 could affect direct spending for deposit insurance by increasing or decreasing amounts paid by the insurance funds to resolve insolvent institutions and to cover the administrative expenses necessary to implement its provisions. Changes in spending related to failed banks and thrifts could be volatile and vary in size from year to year, but any such costs would be offset by insurance premiums. Thus, their budgetary impact would be negligible over time. The major budgetary impact of H.R. 10 would stem from an increase in the annual payments by the FHLBs for interest on bonds issued by the REFCORP. As a result, Treasury outlays for such interest would decline. In addition, changes in regulatory activities would result in small outlay increases and revenue decreases.

Deposit Insurance Funds. Enacting H.R. 10 could affect the federal budget by causing changes in the government's spending for deposit insurance, but CBO has no clear basis for predicting the direction or the amount of such changes. Changes in spending for deposit insurance could be significant in some years, but would have little or no net impact on the budget over time.

A number of provisions in the act could affect spending by the deposit insurance funds. Some are likely to reduce the risks of future bank failures. For example, H.R. 10 would permit affiliations of banking, securities, and insurance companies, thereby giving such institutions the opportunity to diversify and to compete more effectively with other financial businesses. Changes in the marketplace, particularly the effects of technology, have already helped to blur the distinctions among financial service firms. Further, regulatory and judicial rulings continue to erode many of the barriers separating different segments of the financial services industry. For example, banks now sell mutual funds and insurance to their customers and, under limited circumstances, may underwrite securities. At the same time, some securities firms offer checking-like accounts linked to mutual funds and extend credit directly to businesses. Because H.R. 10 would clarify the regulatory and legal structure that currently governs bank activities, CBO expects that its enactment would allow banks to compete more effectively in the rapidly evolving financial services industry. Diversifying income sources also could result in lower overall risks for banks, assuming that the expansion of their activities is accompanied by adequate safeguards. H.R. 10 would specifically prohibit the FDIC from using the resources of the Bank Insurance Fund (BIF) to assist affiliates or subsidiaries of insured financial institutions.

It is also possible, however, that losses to the deposit insurance fund could increase as a result of enacting H.R. 10. The increase in size and complexity of the new financial holding companies could challenge the ability of the regulators to manage any additional risk of losses to the deposit insurance funds. If additional losses were to occur, the BIF would increase premiums that banks pay for deposit insurance. Similarly, if losses were to decrease, banks might pay smaller premiums. As a result, the net budgetary impact is likely to be negligible over time in either case.

Federal Home Loan Banks. The act would make a number of reforms to the FHLB system. Beginning in 1999, membership in the FHLB system would become voluntary. H.R. 10 also would require the FHLBs to replace the $300 million annual payment for the interest on bonds issued by the REFCORP with an assessment set at 20.75 percent of the FHLBs' net income. The Federal Housing Finance Board, which regulates the FHLBs, would be authorized to extend or shorten the period over which payments are made such that, over time, the average payment would equal $300 million a year, on a present-value basis.

Based on CBO's analysis of the FHLB system's balance sheet and income statement, and using CBO's baseline economic assumptions, we estimate that the provisions affecting the FHLBs would increase their payments to REFCORP by $89 million in 1999 and a total of $354 million over the 1999-2003 period. CBO expects that the estimated increase in payments in the near term would be offset by a decrease in payments of an equal amounts (on a present-value basis) in future years.

The FHLB system is a government-sponsored enterprise and its activities are not included in the federal budget. But, because the Treasury pays the interest on REFCORP bonds not covered by the FHLBs, this change would reduce Treasury outlays by $354 million over the five-year period.

Regulatory Costs. The Federal Reserve, the Securities and Exchange Commission, the Federal Trade Commission (FTC), the Treasury, state banking regulators, and federal banking regulators—the Office of the Comptroller of the Currency (OCC), the FDIC, and the Office of Thrift Supervision (OTS)—would have primary responsibility for monitoring compliance with the statute.

H.R. 10 would impose consumer protection regulations governing retail sales of nondeposit products and other requirements. The banking agencies would be required to monitor financial institutions to ensure that disclosure and advertising of various financial products complied with the statute, to implement new regulations, policies, and training procedures related to securities, insurance and other areas, and to strengthen examination procedures for financial holding companies. CBO expects that the FDIC would spend about $1 million in 1999 and $2 million annually in subsequent years for these new activities. The OCC and the

OTS would also incur expenses for these purposes, but they would be offset by increased fees, resulting in no net change in outlays for those agencies.

Based on information from the Federal Reserve, CBO estimates that H.R. 10 would require the Federal Reserve to incur added examination costs of about $4 million per year once the act's requirements are fully effective in 2000. These costs would be necessary to supervise the activities of the new bank holding companies, as well as the new wholesale financial institutions (WFIs), which would not accept retail insured deposits. The Federal Reserve's cost of processing applications could also be affected. Applications for nonbanking activities could decrease but applications for the newly authorized activities of holding companies could increase. We expect that these changes would be roughly offsetting, resulting in no significant net budgetary impact.

Because the Federal Reserve system remits its surplus to the Treasury, changes in its operating costs would affect governmental receipts. The net effect of the changes in H.R. 10 would be to reduce governmental receipts by $17 million over the 1999-2003 period.

Spending Subject to Appropriation

A number of federal agencies would be responsible for monitoring changes resulting from enactment of H.R. 10. CBO estimates that total costs, assuming appropriation of the necessary amounts, would be about $1 million in 1999 and $3 million to $4 million annually beginning in 2000, primarily for expenses of the FTC, GAO, and the Treasury Department. The SEC would incur costs to monitor market conditions, to examine firms, to insure the privacy of personal financial information, and to investigate practices to ensure compliance with the statute. We expect these additional rulemaking, inspection, and administrative expenses of the SEC would range between $1 million and $2 million annually.

H.R. 10 would require seven reports, assigning responsibility to GAO to conduct five studies, and the FTC and the FDIC to each prepare one study. GAO would prepare an annual study evaluating competition in the financial services industry, and also examine market concentration issues, analyze fees associated with financial products, and consider issues arising from enactment of H.R. 10. CBO estimates that GAO would spend $1 million to $2 million annually to collect and analyze data and prepare the reports. The Treasury would work with the Federal Reserve Board to evaluate the nature of products the financial institutions offer, and the FTC, the Department of Justice, and the FDIC would review the antitrust implications of bank acquisitions. CBO expects that the additional costs of these responsibilities would total about $1 million annually.

PAY-AS-YOU-GO CONSIDERATIONS

The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. Legislation providing funding necessary to meet the deposit insurance commitment is excluded from these procedures. Most of the FDIC's additional costs that would result from this bill (about $2 million a year) would be covered by this exemption. CBO believes that the various costs of H.R. 10 related to consumer protection would not qualify for the exemption that applies to the full funding of the deposit insurance commitment and thus would count for pay-as-you go purposes. We estimate that the increase in the FDIC's supervisory costs for such purposes would be small, however, and total less than $500,000 annually. Costs for similar activities of the OCC and the OTS would be offset by increases in fees of an equal amount, resulting in no significant net budgetary impact for those agencies.

CBO estimates that provisions affecting the FHLBs would result in an increase in their payments for REFCORP interest and a corresponding decreasing in Treasury outlays, totaling $795 million over the 1999-2008 period.

CBO expects that the Federal Reserve would incur additional expenses associated with consumer issues that are not directly related to protecting the deposit insurance commitment. We estimate that the resulting increase in regulatory and other costs would reduce the surplus payment that the Federal Reserve remits to the Treasury by less than $500,000 annually.

The net changes in outlays and governmental receipts that are subject to pay-as-you-go procedures are shown in the following table. For the purposes of enforcing pay-as-you-go procedures, only the effects in the budget year and the succeeding four years are counted.

	By Fiscal Year, in Millions of Dollars									
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Changes in outlays										
FDIC	0	0	0	0	0	0	0	0	0	0
REFCORP payment	-89	-95	-67	-53	-50	-56	-70	-87	-105	-123
Total	-89	-95	-67	-53	-50	-56	-70	-87	-105	-123
Changes in receipts	0	0	0	0	0	0	0	0	0	0

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 10 contains several intergovernmental mandates as defined in UMRA. CBO estimates that the total cost of complying with these mandates—primarily preemptions of state laws—would be less than $10 million a year. The bill contains other provisions, which are not mandates, but which CBO estimates would affect the budgets of state and local governments. H.R. 10 would not impose mandates or have significant budgetary impacts on local or tribal governments.

Mandates

A number of provisions in H.R. 10 would preempt state banking, insurance, and securities laws. States would not be allowed to prevent banks from engaging in certain activities (such as selling insurance and securities) authorized under the act, nor would they be allowed to restrict the reorganization of mutual insurers (except in the state of domicile of the insurer). Such preemptions are mandates under UMRA. Based on information provided by groups representing state and local governments, including the National Conference of State Legislatures (NCSL), CBO estimates that enactment of these provisions would not result in direct costs or lost revenue to state governments because, while they would be prevented from enforcing certain rules and regulations, they would not be required to undertake any new activities.

Subtitle B of Title III of the bill would require a majority of states (within three years of enactment of H.R. 10) to enact uniform laws and regulations governing the licensing of individuals and entities authorized to sell insurance within the state. If a majority of states do not enact such laws, certain state insurance laws would be preempted and a National Association of Registered Agents and Brokers (NARAB) would be established. The purpose of the association would be to provide a mechanism through which uniform licensing, continuing education, and other qualifications could be adopted on a multistate basis. Membership in NARAB would be voluntary and open to any state-licensed insurance agent.

If NARAB is established, states would maintain the core functions of regulating insurance, such as licensing, supervising, and disciplining insurance agents and protecting purchasers of insurance from unfair trade practices, but certain state laws would be preempted. Specifically, the bill would prevent states from discriminating against members of NARAB by charging different licensing fees based on residency. Based on information from the National Association of Insurance Commissioners about the number of out-of-state agents and current state license fees, CBO estimates that these preemptions would result in the loss of license fees to states totaling less than $10 million a year.

Other Impacts

Enactment of H.R. 10 would result in additional administrative and legal costs and revenues to state regulatory agencies. Certain provisions of the bill could lead to the establishment of new bank subsidiaries or affiliates involved in insurance or securities activities. Because most states already allow banks to be involved in such activities, we expect that any additional costs would be small. In general, costs incurred by states would be offset by additional examination and licensing fees.

The bill would also expand the definition of "investment adviser" under the Investment Advisers Act, which would increase the number of advisers registering with states and thereby increase revenues from fees. Based on information from the North American Securities Administrators Association, CBO estimates that additional filing and registration fees would total approximately $1 million annually.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

H.R. 10 would impose several private-sector mandates as defined in UMRA. CBO's analysis of those mandates is contained in a separate statement of private-sector mandates.

PREVIOUS CBO ESTIMATES

On September 12, 1997, CBO prepared a cost estimate for H.R. 10, as reported by the House Committee on Banking and Financial Services on July 3, 1997. CBO estimated direct spending would increase by $62 million over the 1998-2002 period, whereas we estimate a savings of $345 million over the first five years for the Senate-reported bill. Two provisions account for most of the difference. As a result of improvements in the financial condition of the FHLBs, CBO now estimates that the change in formula for the FHLBs' contribution to REFCORP interest would produce substantially more outlay savings in the first several years than previously estimated. Most of the remaining difference in direct spending is attributable to provisions in the House bill (but not in the Senate bill) that would abolish the thrift charter and transfer supervisory responsibility for the OTS to the other financial regulatory agencies. Differences in estimates of spending subject to appropriation and revenues are not significant.

On December 5, 1997, CBO prepared a cost estimate for H.R. 10, as reported by the House Committee on Commerce on November 3, 1997. CBO estimated that direct spending would total $103 million over the five-year budget period, or $441 million higher than the Senate version. The House Commerce Committee's version of H.R. 10 would abolish the thrift charter (at an estimated five-year cost of $87 million), but would not change the FHLB payments as would the Senate Banking Committee's version (with five-year savings of $354 million).

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